

University of Minnesota Law School  
**Scholarship Repository**

---

Minnesota Law Review: Headnotes

---

2009

## A Better Solution to Moral Hazard in Employment Arbitration: It Is Time to Ban Predispute Binding Arbitration Clauses

Lisa Blomgren Bingham

David Henning Good

Follow this and additional works at: <https://scholarship.law.umn.edu/headnotes>

 Part of the [Law Commons](#)

---

### Recommended Citation

Bingham, Lisa Blomgren and Good, David Henning, "A Better Solution to Moral Hazard in Employment Arbitration: It Is Time to Ban Predispute Binding Arbitration Clauses" (2009). *Minnesota Law Review: Headnotes*. 1.

<https://scholarship.law.umn.edu/headnotes/1>

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review: Headnotes collection by an authorized administrator of the Scholarship Repository. For more information, please contact [lenzx009@umn.edu](mailto:lenzx009@umn.edu).

---

---

## Response Article

# A Better Solution to Moral Hazard in Employment Arbitration: It Is Time to Ban Predispute Binding Arbitration Clauses

Lisa Blomgren Bingham<sup>†</sup> and David Henning Good<sup>‡</sup>

Mandatory arbitration is a neologism that describes the capacity of an economically stronger repeat player to impose an adhesive binding arbitration clause on the weaker, usually one-shot, player. Such agreements appear frequently as a condition of some economic relationship, most problematically employment, consumer purchases, or health care.<sup>1</sup> Employers and businesses adopt adhesive arbitration clauses as a means to manage the risk of litigation and perceived “runaway” jury awards.<sup>2</sup> Professor Michael LeRoy, together with his colleague Professor Peter Feuille, has made a series of important empirical and substantive contributions to the dialogue and controversy.<sup>3</sup> In his recent article appearing in the *Minnesota Law*

---

<sup>†</sup> Keller-Runden Professor of Public Service, Indiana University School of Public and Environmental Affairs, Bloomington, Indiana.

<sup>‡</sup> Associate Professor of Public and Environmental Affairs and Director of the Transportation Research Center, Indiana University School of Public and Environmental Affairs, Bloomington, Indiana. Copyright © 2009 by Lisa Blomgren Bingham and David Henning Good.

1. For reviews of the literature, see Michael H. LeRoy, *Do Courts Create Moral Hazard?: When Judges Nullify Employer Liability in Arbitrations*, 93 MINN. L. REV. 998, 1001 n.13 (2009).

2. Lisa B. Bingham, *Control Over Dispute-System Design and Mandatory Commercial Arbitration*, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 221, 221–23 (arguing that repeat players that control the design of arbitration systems manage risk by shifting transaction costs to the one-shot player to reduce the settlement value of a case and discourage litigation).

3. Michael H. LeRoy, *Getting Nothing for Something: When Women Prevail in Employment Arbitration Awards*, 16 STAN. L. & POL’Y REV. 573, 573–81 (2005); Michael H. LeRoy, *Jury Revival or Jury Reviled? When Employees Are Compelled to Waive Jury Trials*, 7 U. PA. J. LAB. & EMP. L. 767, 767–72 (2005); Michael H. LeRoy, *Misguided Fairness? Regulating Arbitration by Statute: Empirical Evidence of Declining Award Finality*, 83 NOTRE DAME L. REV.

*Review*,<sup>4</sup> Professor LeRoy outlines the debate over mandatory arbitration and proposes another way to view the developing and divided case law: that courts create conditions of moral hazard by vacating arbitration awards that employees win.

Professor LeRoy reviews the grounds for overturning an arbitration award under the Federal Arbitration Act,<sup>5</sup> Labor Management Relations Act,<sup>6</sup> Uniform Arbitration Act,<sup>7</sup> Revised Uniform Arbitration Act,<sup>8</sup> and common law standards of review devised by federal courts and imported into the jurisprudence of state courts.<sup>9</sup> He argues that courts effectively serve as an insurance plan for employers, protecting them against liability for their own wrongdoing in violating state or federal employment law.<sup>10</sup> Reporting data showing that state trial and appellate courts overturn arbitration awards favoring employees at a slightly higher frequency than they do awards favoring employers, Professor LeRoy argues for a twofold solution: (1) return to strict enforcement of the four limited grounds for overturning an award specified in the Federal Arbitration Act, and (2) require employers to pay the relief ordered by the arbitrator before proceeding to hear a motion to vacate the award. This second prescription makes a good deal of sense given Professor LeRoy's review of the case law and regardless of the data.

However, we argue that the data do not support Professor LeRoy's first recommendation, and that enforcing the narrow FAA review standards will not address the many abuses presented by mandatory arbitration. With all due respect, there is another way. Just ban predispute arbitration clauses in employment and consumer disputes; do it now. It is an elegant solution. It rescues public law that has been put at risk by the

---

551 (2008); Michael H. LeRoy & Peter Feuille, *When Is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 UCLA L. REV. 143, 143–44 (2002).

4. LeRoy, *supra* note 1.

5. 9 U.S.C. §§ 1–14 (2006).

6. 29 U.S.C. §§ 141–144 (1947).

7. UNIF. ARBITRATION ACT § 12 (amended 2000), 7 U.L.A. 497 (1956).

8. UNIF. ARBITRATION ACT § 23, 7 U.L.A. 73–83 (2000).

9. See LeRoy, *supra* note 1, at 1022.

10. Predispute employment-arbitration clauses cover claims of discrimination based on race, sex, age, disability, religion, or other grounds; claims of wrongful or retaliatory discharge for reports that are protected by public policy; intentional infliction of emotional distress; breach of implied covenant of good faith and fair dealing; breach of express contract; and a number of other claims. For an empirical report on these claims, see Lisa B. Bingham, *Emerging Due Process Concerns in Employment Arbitration*, 47 LAB. L.J. 108 (1996).

unchecked growth of mandatory arbitration. It regulates the “wild west” processes creative counsel are designing to manage risk on behalf of their clients. It brings us back from almost two decades of a laissez faire, failed approach to balancing the great value of binding arbitration with the potential for its abuse in the hands of the economically powerful.

In this commentary we first address the data Professor LeRoy cites in support of his argument. We supply additional analyses of his tables to explore the strength of his findings. We address the degree to which these findings support his recommendation to enforce FAA standards universally. Next, we examine the proposals to return fairness to arbitration as an alternative solution to the policy issue of mandatory arbitration. We conclude that the FAA, as the Supreme Court has interpreted it lately, is the problem and not the solution. The solution is legislation to ban predispute arbitration agreements for employment, health care, and consumer disputes.

#### I. A CLOSER LOOK AT THE DATA: LESS THAN MEETS THE EYE

Professor LeRoy used online databases of federal and state cases involving arbitrations between individual employees and employers with cases decided between 1975 and 2007, a period encompassing thirty-three years.<sup>11</sup> He identified 267 cases in which employment arbitration awards were challenged in federal or state court, an average of eight cases a year. In addition, he examined appellate-court decisions in 176 cases, for a total sample of 443 cases. Professor LeRoy reports four tables for federal district court (160 cases), state trial court (107 cases), federal appellate court (83 cases), and state appellate court (93 cases) cases. First, he codes cases by whether the employee won, the employer won, or the award was split. Second, he codes cases by whether the court confirmed the award, partly confirmed it, or vacated it. He then uses a chi-square analysis to examine the pattern of case frequencies across two dimensions.<sup>12</sup> He finds no significant results in the federal district

---

11. See LeRoy, *supra* note 1, at 1044.

12. Chi-square can be problematic when there are fewer than five observations expected to fall into cells of the table. See Shelby J. Haberman, *A Warning on the Use of Chi-Squared Statistics with Frequency Tables with Small Expected Cell Counts*, 83 J. AM. STAT. ASS'N 555, 555–60 (1988). In practice, one or two cells violating this rule of thumb is not serious but roughly half of the cells violate this guideline across the four tables. A better test is Fisher's Exact Test, which in this case yields slightly different probability val-

courts. He finds that federal appellate courts are more likely to vacate awards when employers win, but that state trial and appellate courts are more likely to vacate awards when employees win.

However, the mere fact that a distribution departs systematically from what we would expect were it random does not mean that this departure is either substantial or one upon which to base important policy decisions. Professor LeRoy's argument relies largely on Tables 2 and 4, which reflect state court cases. In each table, he compares the number of employer wins and employee wins that the court vacates. In Table 2, state trial courts vacate six employer wins and ten employee wins. The absolute difference in frequency is thus a total of four cases over a period of thirty-three years in the state trial courts. In Table 4, state appellate courts vacated five employer wins and ten employee wins, for a difference in frequency of five cases over a period of thirty-three years in the state appellate courts. By converting these very low frequencies into percentages,<sup>13</sup> Professor LeRoy argues that state appellate courts "vacated many more wins for employees than for employers."<sup>14</sup>

However, in essence, Professor LeRoy's argument boils down to a claim that four cases in state trial courts or five cases in state appellate courts over a period of thirty-three years is enough of a pattern (1) to be obvious to employer counsel and (2) to induce them to use the courts as insurance against their own liability. This is highly unlikely. Professor LeRoy himself observes, "My empirical study does not measure employer responses to court rulings that vacate pro-worker awards."<sup>15</sup> Moreover, his data suggest the overwhelmingly strong tendency of courts to confirm arbitration awards, without regard to which party won in arbitration.<sup>16</sup>

---

ues for each table, but does not change the substantive results. The *p* value for Table 1 changes from .724 to .709, still not significant. The *p* value for Table 2 changes from .010 to .028, which is still significant. The *p* value for Table 3 changes from .008 to .009, still significant. The *p* value for Table 4 changes from .032 to .018, still significant.

13. See LeRoy, *supra* note 1, at 1048 ("Table 4 illustrates that state courts confirmed 86.7% of pro-employer awards but only 56.4% of employee wins at arbitration.").

14. *Id.*

15. *Id.* at 1010.

16. See *id.* at 1045–46 tbls.1, 2, 3, & 4. The tables' first columns are so heavily skewed in terms of confirming awards that the most likely outcome that any plaintiff would expect is confirmation of the award, regardless of the winner, regardless of the court. Two measures of association which describe

In sum, the evidence that courts create conditions of moral hazard by insuring employers against adverse arbitration awards is weak. The data show that it continues to be difficult for either party to overturn a binding arbitration award, whether in federal or state court and regardless of the standard of review. The majority of courts confirm the majority of awards, whether employer or employee wins.

## II. MORAL HAZARD AT THE POINT OF MOTIONS TO VACATE IS NOT THE PROBLEM, AND NARROWING JUDICIAL REVIEW IS NOT THE SOLUTION

On the theory of moral hazard for employers and reasoning that, even when they lose in court, employers as repeat players acquire strategic advantage from the arbitration experience,<sup>17</sup> Professor LeRoy proposes two solutions. First, he proposes to address the abuses he documents in individual case descriptions of courts throwing out awards favoring employees by requiring that employers pay up front when they seek to challenge an adverse award.<sup>18</sup> This is an excellent proposal fully justified by Professor LeRoy's review of the case law.

---

the strength of the relationship in this case are Lambda (which treats both the arbitration winner and court decision as nominal) and Somers' D (which treats both arbitration winner and court decision as ordinal, with partial awards and partial confirmations as middle categories). In the case of Lambda, none of the relationships between outcomes in the tables have any predictive strength, that is, Lambda is zero for all cases were we to use arbitration winner to predict case disposition. This measure is insensitive to the rare numbers of outcomes that drive Professor LeRoy's story. A measure more favorable to his case is Somers' D which counts concordance and discordance among pairs of cases. Concordance occurs when the direction of change among one variable, arbitration winner, is the same direction as change for the other variable, case disposition. Like a correlation, Somers' D ranges from complete discordance, -1, to complete concordance, +1, with zero indicating no relationship. The positive direction is considered going down or to the right in the tables. Consequently, positive values of Somers' D indicate that employee-won arbitrations are more likely to be vacated and employer-won arbitrations are more likely to be confirmed. Values of Somers' D for Tables 1-4 are -.0065, .0795, .0091, and .2453. So, only in the case of Table 4 is the strength of the relationship anything other than minuscule. The bottom line is that a layperson's intuition is correct here; four or five cases over thirty-three years do not make for a very strong effect.

17. Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 213 (1997); Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 238 (1998); Lisa B. Bingham, *Self-Determination in Dispute System Design and Employment Arbitration*, 56 U. MIAMI L. REV. 873, 893 (2002).

18. LeRoy, *supra* note 1, at 1054.

His second proposal is that state and federal courts return to strict construction of the Federal Arbitration Act's very limited standards for judicial review of binding arbitration awards.<sup>19</sup> There is no question that courts adhering exclusively to these standards would make it more difficult for both parties to overturn an award by eliminating grounds for vacatur such as an award contrary to public policy or in manifest disregard of the law.<sup>20</sup>

However, there are three problems with using Professor LeRoy's sample to support this proposal. First, we do not know the total number of employment arbitration awards and whether Professor LeRoy's cases are representative. Second, the results may stem from a lack of employee resources rather than moral hazard for employers. Third, we do not know why employees and employers file motions to vacate, and they may have very different motivations leading to systematic differences in these two groups of cases.

We do not have good national data regarding the underlying population of employment arbitration cases from which this court sample is the very tip of the iceberg. In other words, we do not know what percentage of all employment arbitrations Professor LeRoy's court sample represents. It is fair to say that this percentage would be very small, and probably less than one percent.<sup>21</sup> In other words, the arbitration cases that end up

---

19. 9 U.S.C. § 10 (2006) provides:

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

20. See LeRoy, *supra* note 1, at 1031–33.

21. For example, Elizabeth Hill reports that under the auspices of the American Arbitration Association (AAA) alone, 429 awards were rendered between Nov. 5, 2000 and Sept. 1, 2002. Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at a Low Cost*, 58 DISP. RESOL. J. 9, 17 n.26 (2003). This is less than a two-year period. The AAA is only one of many providers, but it is a prominent one. Cf. Thomas J. Stipanowich, *ADR and the "Vanishing Trial"*:

in court are probably not representative of employment arbitration cases as a whole. Most employer lawyers generally know this, which makes a moral hazard effect even less likely to result in a motion to vacate the average employment arbitration award.

Taking the sample at face value, it is fair to infer that it does not reflect the number of employees who would challenge adverse awards if they could, if they had counsel and the resources. Most employees are in employment arbitration as the result of dismissal and have lost their income and have fewer resources than they would otherwise.<sup>22</sup> As Professor LeRoy observes, employees are less likely than employers to challenge the finality of a binding arbitration award, because they are less able to get the assistance of counsel.<sup>23</sup> In most cases, the amount in dispute is relatively small, and thus unlikely to attract counsel on a contingent fee basis. What if employees were able to get counsel and challenge adverse awards more frequently? For example, some have suggested that unions may

---

*The Growth and Impact of "Alternative Dispute Resolution"*, 1 J. EMPIRICAL LEGAL STUD. 843, 872 (2004) (calculating that AAA handled 136,613 to 150,009 arbitration cases a year between 1999 and 2002); AM. ARBITRATION ASS'N, 2005 PRESIDENT'S LETTER & FINANCIAL STATEMENTS 8 (2005), *available at* <http://www.adr.org/si.asp?id=4301> (observing that by 2005, AAA's annual caseload had dropped to about 142,000, as compared to 159,000 cases in 2004).

Third party providers must disclose certain data pursuant to California state law. *See* CAL. CIV. PRO. CODE § 1281.96 (West 2007). In an unpublished paper presented at the American Bar Association Section of Dispute Resolution conference in 2005, we examined arbitration disclosure statements reflecting a two-year caseload of over 4,000 arbitrations, analysis of a sample of which reflected that 32%, or roughly 1280, were employment cases. Lisa Blomgren Bingham, Jean Sternlight, & John Healey, *Arbitration Data Disclosure in California: What we Have and What we Need* (2005) (on file with author). A third-quarter 2008 AAA report listed over 22,000 cases, including employment, consumer, construction, and other forms of commercial arbitration. AM. ARBITRATION ASS'N, CCP SECTION 1281.96 DATA COLLECTION REQUIREMENTS 3209 (2008), *available at* <http://www.adr.org/si.asp?id=5468>. This report includes both settled and awarded cases. *See generally id.* Thus, a comparison of Hill's sample with these disclosures shows a rapid growth in employment arbitration as a category of cases.

However, we have neither comprehensive data on compliance with these rules, nor systematic analyses of the contents of the disclosures. Assembling this data would be a daunting task, as the third-quarter 2008 AAA report was over 3200 pages long.

22. Employers may file arbitration claims against employees for matters such as return of unearned commissions or use of trade secrets. However, it is difficult to document the relative frequency of these claims.

23. LeRoy, *supra* note 1, at 1008 n.56.



create an associate member status for workers in nonunion facilities and provide representation services in employment arbitration in exchange for membership dues.<sup>24</sup> Professor LeRoy points to the federal district court data from Table 1, which shows no significant difference for employers and employees in vacated awards in their favor. Impliedly, moral hazard is absent in this case. Thus, if a change in access to counsel changed the pattern of motions to vacate, presumably the evidence upon which Professor LeRoy bases his moral hazard argument for motions to vacate could disappear.

There is much to suggest that court decisions on motions to vacate employment arbitration awards are not typical of all the cases that go to arbitration, since only a very small number of those cases reach judicial review. If they are not typical, why are these cases in court? This analysis does not ask an important question: Why do employers and employees file motions to vacate? Professor LeRoy's analysis concludes that employers file as a result of moral hazard.

However, we analyzed a sample of 48,000 mediation cases involving complaints of employment discrimination from the USPS REDRESS program.<sup>25</sup> While these are clearly different circumstances (mediation as opposed to mandatory arbitration, and typically much smaller stakes), they do suggest that participants think about the resolution of the case differently. We found managers are more likely to consider the problem entirely resolved, while employees view it as only partially resolved at the end of mediation. Moreover, managers are more likely to view the case as resolved if they consider the process to be fair, while employees are more likely to consider it resolved if they view the outcome to be fair. This suggests employees and employers may be pursuing different goals when they file motions to vacate. To the extent that these behaviors operate here, it

---

24. Bingham, *supra* note 10, at 119 (arguing that unions could provide representation services in employment arbitration through associate-member status); Kenneth G. Dau-Schmidt, *The Changing Face of Collective Representation: The Future of Collective Bargaining*, 82 CHI.-KENT L. REV. 903, 929 (2007) ("The AFL-CIO has seriously stepped up its associate membership program, 'Working America,' which attempts to unite and motivate working people on larger social and political issues of common concern even if they do not currently work in a union workplace. The program currently has almost a million members.").

25. Tina Nabatchi, Lisa Blomgren Bingham, & David H. Good, *Organizational Justice and Workplace Mediation: A Six Factor Model*, 18 INT'L J. CONFLICT MGMT. 148 (2007).

may suggest that employees more than employers are seeking another bite at the apple, and the courts are saying no.

For all of these reasons, this sample does not support an inference that courts are creating moral hazard for employers at the level of a motion to vacate an arbitration award.

### III. BANNING PREDISPUTE ARBITRATION CLAUSES IN EMPLOYMENT: A BETTER SOLUTION

The true public policy problem inherent in binding predispute employment arbitration is not moral hazard for employers at the stage of judicial review. The moral hazard arises from the mere existence of mandatory arbitration and employers' power to design arbitration systems to their advantage free from any significant regulation.<sup>26</sup> Using this ability, employers can give themselves "get out of jail free" cards to escape liability under the public law of employment. It is precisely because the grounds for judicial review are already so limited, and because employees have few resources to pursue those grounds, that employers are pushing the envelope to create skewed arbitration dispute system designs. Making it even harder to overturn skewed system designs in court, as Professor LeRoy advocates, will not solve that problem.

Up until recently, the major players in the field of arbitration have endeavored to use self-regulation to address abuses through voluntary protocols.<sup>27</sup> These protocols provide procedural protections in the form of rights to counsel, limited reasonable discovery, participation in selection of the arbitrator, a reasoned decision, and other elements associated with procedural due process of law. Some courts have cited such protocols as persuasive authority on the fairness of an arbitration process.<sup>28</sup> Moreover, there is evidence that when a third party

---

26. See Bingham, *supra* note 2, at 231, 239–43, for a discussion of control over dispute system design and mandatory arbitration.

27. For example, see Am. Bar Ass'n, *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship*, GP|SOLO, [http://www.abanet.org/genpractice/magazine/1997/fall-bos/lab\\_emp.html](http://www.abanet.org/genpractice/magazine/1997/fall-bos/lab_emp.html) (last visited Mar. 24, 2009).

28. For a review and assessment of the Employment Protocol, see Richard A. Bales, *The Employment Due Process Protocol at Ten: Twenty Unresolved Issues, and a Focus on Conflicts of Interest*, 21 OHIO ST. J. ON DISP. RESOL. 165, 184–96 (2005); Margaret M. Harding, *The Limits of the Due Process Protocols*, 19 OHIO ST. J. ON DISP. RESOL. 369, 401–56 (2004); and Martin H. Malin, *Due Process in Employment Arbitration: The State of the Law and the Need for Self-Regulation*, 11 EMP. RTS. & EMP. POL'Y J. 363, 386–403 (2007). Professor Malin concludes that courts have abdicated their responsibility to

provider enforces the Employment Protocol as to cases it administers, the pattern of arbitration outcomes changes in employees' favor compared to a pre-protocol case sample; in other words, self-regulation can make a difference.<sup>29</sup> However, protocols are not law; their effectiveness is constrained by the willingness of parties voluntarily to comply.

The better solution is to abandon the *laissez-faire* approach<sup>30</sup> embodied in the Supreme Court's arbitration jurisprudence since *Gilmer*.<sup>31</sup> Clearly, the Supreme Court is not going to do this, so Congress is going to have to do it for them. The 110th Congress considered a variety of proposals to reverse through legislation the Supreme Court's dramatic expansion of the FAA's preemptive effect. One recent proposal was the Arbitration Fairness Act of 2007.<sup>32</sup> It would have amended the Federal Arbitration Act to provide:

---

police arbitration agreements for fairness, and that self-regulation in the form of the major third-party-provider agencies such as AAA and JAMS refusing to administer skewed programs can go some distance to filling the gap. Main, *supra*, at 403.

29. Lisa B. Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence That Self-Regulation Makes a Difference*, in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA 303 (Samuel Estreicher & David Sherugh eds., 2004).

30. See Paul D. Carrington, *Self-Deregulation, the "National Policy" of the Supreme Court*, 3 NEV. L.J. 259, 264 (2003) (critiquing the Supreme Court's construction of the Federal Arbitration Act as permitting economic predators to contract out of the private system for law enforcement and "thereby exposing consumers, employees, small businesses, and other persons of limited economic bargaining power to a thousand wounds").

31. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24–26 (1991) (enforcing an arbitration clause in a Securities and Exchange Commission registration form for an employment dispute on the theory that it was a change in forum not substance and federal policy supports arbitration).

32. H.R. 3010, 110th Cong. (2007). This bill contains findings including:

(1) The Federal Arbitration Act (now enacted as chapter 1 of title 9 of the United States Code) was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power.

(2) A series of United States Supreme Court decisions have changed the meaning of the Act so that it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes. As a result, a large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have disputes resolved by a judge or jury, and instead submit their claims to binding arbitration.

(3) Most consumers and employees have little or no meaningful option whether to submit their claims to arbitration. Few people realize, or understand the importance of the deliberately fine print that strips them of rights; and because entire industries are adopting

No predispute arbitration agreement<sup>33</sup> shall be valid or enforceable if it requires arbitration of—

(1) an employment,<sup>34</sup> consumer,<sup>35</sup> or franchise dispute;<sup>36</sup> or

(2) a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power.<sup>37</sup>

The Arbitration Fairness Act of 2009 is under consideration in the current session of Congress.<sup>38</sup> Its most recent version addresses technical concerns by placing its provisions in a new Chapter 4 of the Federal Arbitration Act and defining the terms related to arbitration of franchise, employee, consumer, and civil rights claims.<sup>39</sup>

---

these clauses, people increasingly have no choice but to accept them. They must often give up their rights as a condition of having a job, getting necessary medical care, buying a car, opening a bank account, getting a credit card, and the like. Often times, they are not even aware that they have given up their rights.

*Id.* § 2(1)–(3).

33. The bill defines “pre-dispute arbitration agreement” to mean “any agreement to arbitrate disputes that had not yet arisen at the time of the making of the agreement.” *Id.* § 3(6).

34. The bill defines “employment dispute” as “a dispute between an employer and employee arising out of the relationship of employer and employee as defined by the Fair Labor Standards Act.” *Id.*

35. The bill defines “consumer dispute” as “a dispute between a person other than an organization who seeks or acquires real or personal property, services, money, or credit for personal, family, or household purposes and the seller or provider of such property, services, money, or credit.” *Id.* § 3(4).

36. The bill defines a “franchise dispute” as “a dispute between a franchisor and franchisee arising out of or relating to contract or agreement by which—

(A) a franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor;

(B) the operation of the franchisee's business pursuant to such plan or system is substantially associated with the franchisor's trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

(C) the franchisee is required to pay, directly or indirectly, a franchise fee . . . .

*Id.* § 3(5).

37. *Id.* § 4(4)(b).

38. Arbitration Fairness Act of 2009, S. 931, 111th Cong. (2009). Senator Russell Feingold introduced the bill on April 29, 2009; it has since been referred to the Committee on the Judiciary.

39. See, e.g., *id.* § 401 (defining “consumer dispute,” “employment dispute,” and “predispute arbitration agreement” while exempting collective bargaining agreements).

This legislative approach amends the FAA to carve out exceptions from its coverage. Another example is the proposed Fairness in Nursing Home Arbitration Act of 2008,<sup>40</sup> which would carve out predispute arbitration agreements involving long-term care.<sup>41</sup> One bill would provide for fairness in livestock and poultry contracts.<sup>42</sup>

An alternative approach is to enact separate legislation to address a category of cases without directly amending the FAA. One proposal would make mandatory arbitration clauses in consumer contracts an unfair and deceptive practice.<sup>43</sup> Another would prohibit mandatory arbitration in homebuilding contracts.<sup>44</sup> Yet another would prohibit mandatory arbitration in

---

40. H.R. 6126, 110th Cong. (2008).

41. The Act provides in relevant part:

(b) INVALIDITY OF PRE-DISPUTE ARBITRATION AGREEMENTS.—A predispute arbitration agreement between a long-term care facility and a resident of such facility (or person acting on behalf of such resident, including a person with financial responsibility for such resident) shall not be valid or specifically enforceable.

*Id.*

42. Fair Contracts for Growers Act, S. 221, 110th Cong. § 2 (2007). It provides in relevant part:

(b) CONSENT TO ARBITRATION.—If a livestock or poultry contract provides for the use of arbitration to resolve a controversy under the livestock or poultry contract, arbitration may be used to settle the controversy only if, after the controversy arises, both parties consent in writing to use arbitration to settle the controversy.

*Id.*

43. Consumer Fairness Act, H.R. 1443, 110th Cong. § 1003 (2007). This proposal would amend the Consumer Credit Protection Act, 15 U.S.C. §§ 1601, and provides in relevant part:

(a) IN GENERAL.—A written provision in any consumer transaction or consumer contract which requires binding arbitration (whether by the terms of such transaction or contract directly or at the request of any party to the transaction or contract) to resolve any controversy arising out of or related to the transaction or contract, or the failure to perform the whole or any part of the transaction or contract shall constitute a violation of this title, shall not be enforceable, and shall be treated as an unfair and deceptive trade act or practice under Federal or State law.

(b) POST-CONTROVERSY AGREEMENTS.—Subsection (a) shall not apply with respect to a written agreement to determine by binding arbitration an existing controversy arising out of a consumer transaction or consumer contract if the written agreement has been entered into by the parties to the consumer transaction or consumer contract after the controversy has arisen.

*Id.*

44. American Homebuyers Protection Act, H.R. 1519, 110th Cong. (2007). It provides in part:

(a) In General- No person engaged in the construction of new houses may require a purchaser to enter into a mandatory arbitration

predatory tax refund anticipation loans.<sup>45</sup> These independent exceptions are viewed by arbitration proponents as raising fewer political problems than an actual amendment of the FAA.

Advocates of mandatory arbitration insist that eliminating predispute arbitration clauses will sound the death knell for any reasonably inexpensive and prompt access to justice for employment disputes, primarily because lawyers will not agree to arbitration on behalf of their clients after the fact.<sup>46</sup>

However, there is another approach: a post-dispute opt out provision. Under this approach, both parties could enter into a predispute arbitration agreement, but that agreement would specifically permit a party to opt out of arbitration once the dispute arises. The federal courts have substantial experience using “opt out” rules in their court-annexed alternative dispute resolution (ADR) programs. Program evaluations conducted in collaboration with the Federal Judicial Center show a consistent pattern: participation rates in programs with an opt out clause are almost as high as participation rates in mandatory court ADR programs.<sup>47</sup>

---

agreement as a condition precedent to entering into a contract for the purchase of a new house.

*Id.* § 2.

45. Taxpayer Abuse Prevention Act, S. 1133, 110th Cong. (2007). It provides in part:

(a) In General- Any person that provides a loan to a taxpayer that is linked to or in anticipation of a Federal tax refund for the taxpayer may not include mandatory arbitration of disputes as a condition for providing such a loan.

*Id.* § 4.

46. See, e.g., Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 314 (2003) (reporting that only six percent of all employment arbitration cases handled by the AAA arise out of post-dispute arbitration agreements); David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail to Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKELEY J. EMP. & LAB. L. 1, 7 (2003) (arguing that lawyers for employers will not agree to postdispute arbitration).

47. See DAVID RAUMA & CAROL KRAFKA, FEDERAL JUDICIAL CENTER, VOLUNTARY ARBITRATION IN EIGHT FEDERAL DISTRICT COURTS: AN EVALUATION 17 (1994), <http://purl.access.gpo.gov/GPO/LPS49863> (finding similar participation rates in three of the four voluntary courts with opt-out procedures to courts with mandatory referral); see also ELIZABETH PLAPINGER & DONNA STIENSTRA, ADR AND SETTLEMENT IN THE FEDERAL DISTRICT COURTS 6 (Federal Judicial Center 1996) (finding similar participation rates in ADR between opt-out programs and mandatory programs).

## CONCLUSION

There are a variety of approaches, or combinations of approaches, to addressing the public policy problem posed by mandatory arbitration and its abuses. Any of these would get to the heart of the problem. That problem is not moral hazard created by courts at the point where employers file a motion to vacate; the greater temptation for employers is to develop a plan that is so skewed in the first instance that employees lose and are discouraged from ever going to court. We need to regulate employers' abuse of control over dispute system design and restore the reputation of arbitration as a fair, efficient, and cost effective alternative to the public justice system.